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May 19, 2000

BY HAND

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
12th Street Lobby, TW-A325
Washington, D.C. 20554

Re: *GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184; Ex Parte Filing*

Dear Ms. Roman Salas:

This is to provide notice of an *ex parte* telephone conversation that took place in the above docket yesterday afternoon between Steve Bradbury of Kirkland & Ellis and Paula Silberthau of the Commission. The purpose of the call was to discuss legal questions raised by the Applicants' Genuity proposal. The attached materials were provided by fax to Ms. Silberthau.

We have previously shown by the text of the Telecommunications Act and express legislative history that in enacting section 3(1), Congress adopted the definition of "affiliate" used in the MFJ and intended it to have the same meaning it had under the MFJ. We have also shown that under the MFJ, the Justice Department, Judge Greene, AT&T and the Bell companies all recognized that options and other convertible rights were not considered "equity interests." Attached are quotations relating to the ALI *Principles of Corporate Governance* that show that those *Principles* are not a "Restatement" of existing law and were the source of significant controversy. These points further underscore what the legislative history makes plain: that Congress did not intend to codify novel concepts used in the ALI *Principles* when it enacted the "affiliate" definition of section 3(1).

Finally, I am also attaching several pages of points relevant to our Genuity proposal.

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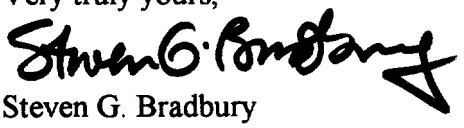
If you have any questions, please contact me.

Very truly yours,



Steven G. Bradbury

Enclosures

cc (w/encl.): Dorothy Attwood
Rebecca Beynon
Michelle Carey
Kyle Dixon
Jordan Goldstein
Johanna Mikes
Paula Silberthau
Lawrence Strickling
Sarah Whitesell
Christopher Wright

The ALI *Principles of Corporate Governance* Are Not a "Restatement" and Do Not Reflect Existing Corporate Law

"*Principles of Corporate Governance: Analysis and Recommendations* and the model it espouses '***swim against too strong a tide to ever make a lasting impression on American corporation law.***'" Dennis J. Block, Stephen A. Radin, Michael J. Maimone, *Derivative Litigation: Current Law Versus the American Law Institute*, 48 Bus. Law. 1443, 1483 (1993) (emphasis added) (quoting Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461, 527 (1992)).

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"The Reporters' presentation of the Project as part of the ALI Restatement tradition creates a real danger the Reporters' views will be accepted by the courts and legislators as a true 'Restatement' of existing law rather than the ***wish-list of reformers*** that it actually is." Jonathan R. Macey, *The Transformation of the American Law Institute*, 61 Geo. Wash. L. Rev. 1212, 1216-17 (1993) (emphasis added).

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"[R]ather than altering the Project to restate existing law, the ALI continued to urge ***radical changes to existing law.***" *Id.* at 1217 (emphasis added).

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"[T]he project had been retitled *Principles of Corporate Governance: Analysis and Recommendations*, ***to allay the fear that courts might be misled by the traditional word 'restatement' in the title to view the entire document as purporting to restate existing law.***" Joel Seligman, *A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 Geo. Wash. L. Rev. 325, 351 (1987) (emphasis added).

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"***No project of the American Law Institute (ALI) has ever been as harshly criticized as its Corporate Governance project.***" *Id.* at 325 (emphasis added).

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"'***It's not a Restatement, it's a "prestatement" of what they think the law should be***, and it shows a complete misunderstanding of how the process operates.'" Tamar Lewin, *The Corporate-Reform Furor*, N.Y. Times, at section D, page 1, column 3 (June 10, 1982) (emphasis added) (quoting Walter B. Wriston, chairman & CEO of Citicorp).

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"***[T]he Principles depart from established law in major areas***, evidenced by comparing the Principles with recent court decisions canvassing the same topics." Alex Elson & Michael L. Shakman, *The ALI Principles of Corporate Governance: A Tainted Process and a Flawed Product*, 49 Bus. Law. 1761, 1761 (1994) (emphasis added).

***

"[T]here was never a general consensus within the ALI about what was wrong with existing corporate law or why the ALI needed to direct its massive intellectual artillery toward changing it. Put another way, ***the Project lacked a theoretical model***. Without such a model, ***the ALI had no basis for analyzing and defending its preferred menu of corporate governance rules***." Jonathan R. Macey, *supra*, 61 Geo. Wash. L. Rev. at 1215 (emphasis added).

***

"The ultimate problem with the ALI Governance Project is that it is ***detached from both the real world and legal tradition***. . . . Ultimately, then, I expect we will be left with 'One Model of Corporate Governance': the existing one. A few courts will be attracted to the supposedly more 'modern' approach of individual provisions of the Governance Project, and parties litigant can be expected to comb its voluminous and wide-ranging Comments for helpful snippets. Thus, we can expect to see the Governance Project cited – perhaps assuring that some of its strange language will be included in the legal lexicon – ***in cases where it will not affect the outcome***. . . . In the final analysis, the ALI Governance Project . . . ***will prove to have been much ado about nothing very much***." Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461, 526-27 (1992) (emphasis added).

The Derivative Suit Provisions of the ALI *Principles* (Relied on Heavily By AT&T) Were a "Lightning Rod" of Controversy and Are Not Consistent With Prevailing Delaware Law, as Recognized By Professor Coffee

"Judging from the vigorous criticism it has provoked, one is tempted to characterize the derivative suit proposals in Part VII of the current ALI Governance Project ***as the lightning rod of the project.*** The ALI Governance Project's derivative suit proposals ***dramatically depart from both existing judicial precedent and from the competing proposals put forth by the American Bar Association's Committee on Corporate Laws in Subchapter D of the Revised Model Business Corporation Act.***" Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461, 462 (1992) (emphasis added) (footnote omitted).

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"***Nothing in the [ALI Principles] proved more controversial than the effort to develop fair and balanced standards for the derivative action.*** Only the topic of corporate takeovers seems to evoke an equally intense level of emotion among corporate lawyers. Not surprisingly, the Part VII (Remedies) of the *Principles* attracted the same attention from critics that a lightning rod does in a thunderstorm." John C. Coffee, *New Myths and Old Realities: The American Law Institute Faces the Derivative Action*, 48 Bus. Law. 1407, 1407 (1993) (emphasis added).

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"The ALI's approach to the derivative action ***differs fundamentally at the outset from that of Delaware*** by abandoning the traditional distinction between 'demand required' and 'demand excused.'" *Id.* at 1415 (emphasis added).

The General Legal Rule Is That Options and Other Conversion Rights Are Not "Equity Interests" and Do Not Constitute Ownership

- Options and conversion rights are not "equity interests":

> "Many cases hold that ***an option contract does not qualify as an equity interest***." *Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 5 (S.D.N.Y. 1997) (emphasis added).
>
> "USAir has ***no present equity interest*** in Shuttle, but it has ***an option*** to purchase a controlling interest in the company effective October 10, 1996." *Association of Flight Attendants v. USAir Inc.*, 24 F.3d 1432, 1435 (D.C. Cir. 1994) (emphasis added).
>
> "A ***debenture*** is a credit instrument which ***does not devolve upon its holder an equity interest*** in the issuing corporation . . . . Similarly, **the convertibility feature of the debenture does not impart an equity element until conversion occurs.**" *Simons v. Cogan*, 549 A.2d 300, 303-04 (Del. 1998) (emphasis added).

- Options do not constitute ownership:

> "An option to purchase stock does not vest in the prospective purchaser ***an equitable title to, or any interest or right, in the stock***." *Ball v. Overton Square, Inc.*, 731 S.W.2d 536, 540 (Tenn. Ct. App. 1987) (emphasis added).
>
> "An option to purchase stock does not vest in the prospective purchaser ***an equitable title to, or any interest or right in, the stock***." 12A Fletcher Cyclopedia of Private Corp. § 5575 (1993) (emphasis added).

Hart-Scott-Rodino Merger Review

- The acquisition of an option or other interest convertible into voting stock does not count as the acquisition of a cognizable ownership interest for purposes of antitrust review under the Hart-Scott-Rodino Antitrust Improvements Act:

> "**Acquisitions of convertible voting securities shall be exempt from the requirements of the act.**
>
> "*Example*: This section applies regardless of the dollar value of the convertible voting securities held or to be acquired and even though they may be converted into 15 percent or more of the issuer's voting securities. Note, however, that **subsequent conversions of convertible voting securities may be subject to the requirements of the act**. See § 801.32."

16 C.F.R. § 802.31 (emphasis added).

Under Commission Precedents, Options and Other Conversion Rights Are Not Cognizable Ownership Interests

- The former cable/telco cross-ownership rules:

  > "**Interests with rights of conversion to equity**, including debt instruments, warrants, convertible debentures, and options, **shall not be included in the determination of cognizable ownership interests unless and until conversion is effected.**" 47 C.F.R. § 63.54(e)(5) (emphasis added); *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244 (1994).

- Section 310's foreign-ownership ban:

  > "**[A]n option** held by a foreigner to buy stock in a licensee or the parent of a licensee **is not cognizable until it is exercised.**" DCR PCS, Inc., Order, DA 96-1816, ¶ 24 (Wireless Bureau Nov. 4, 1996) (emphasis added).

- LEC/LMDS cross-ownership rules:

  > "Debt and interests such as warrants and convertible debentures, options, or other interests (except non-voting stock) with **rights of conversion to voting interests shall not constitute attributable interests unless and until conversion is effected.**" Local Multipoint Distribution Service and Fixed Satellite Services, 12 FCC Rcd 12545 (1997) (emphasis added) (adopting 47 C.F.R. § 101.1003(e)(5)).

- CMRS spectrum cap rules:

  > "Debt and instruments such as warrants, convertible debentures, options, or other interests (except non-voting stock) with **rights of conversion to voting interests shall not be attributed unless and until conversion is effected.**" 47 C.F.R. § 20.6(d)(5) (emphasis added).

The Definition of "Affiliate" in Section 3(1) Was Taken From the MFJ and Was Intended To Have the Same Meaning

- Section IV(A) of the MFJ provided:

> "Affiliate" means any . . . entity . . . that is under direct or indirect common ownership with or control by AT&T or is owned or controlled by another affiliate. For the purposes of this paragraph, the terms "ownership" and "owned" mean a direct or indirect **equity interest (or the equivalent thereof)** of more than fifty (50) percent of an entity.

- Section 106 of the Antitrust and Communications Reform Act of 1994, which was the predecessor of the Telecommunications Act of 1996, *see* 142 Cong. Rec. H1145 (Feb. 1, 1996) (Rep. Markey); 141 Cong. Rec. H8269 (Aug. 2, 1995) (Rep. Bliley); H.R. Rep. 104-204(I), 94th Cong., 1st Sess. 203 (1995), contained the following definition of "affiliate":

> The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For purposes of this paragraph, to own refers to owning an **equity interest (or the equivalent thereof)** of more than 50 percent.

H.R. Rep. No. 559(I), 103d Cong., 2d Sess. 20 (1994) (Energy and Commerce Committee) (emphasis added).

- Congress intended section 106 to have the same meaning as the MFJ:

> Section 106 of the bill contains the definitions to the terms used in title I of the Act. The definition of "affiliate" [and other terms relating to the BOC restrictions] are drawn from definitions in the MFJ. ***The Committee intends that these terms have the same meaning as under the MFJ.***

H.R. Rep. No. 559(I), 103d Cong., 2d Sess. 130 (1994) (emphasis added); *see also* H.R. Rep. 103-559(II), 103d Cong., 2d Sess. 227 (1994) (Judicial Committee) (same).

The Justice Department, Judge Greene and AT&T All Recognized in the MFJ Context That Options and Other Conditional Interests Are Not "Equity Interests" or Ownership

- **The Justice Department:**

  "During the interim period [while NYNEX held the option], ***NYNEX would not have any kind of equity interest*** in Tel-Optik." Report of the United States to the Court Concerning Proposed Purchase by NYNEX Corp. of Conditional Interest in Tel-Optik, Ltd., at 10, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed June 20, 1986) (emphasis added).

  "The conditional interest to be secured by NYNEX ***does not constitute an 'equity interest'*** as that term is normally used." *Id.* at 12 (emphasis added).

  "NYNEX Will ***Not Acquire an Equity Interest*** in Tel-Optik As a Result of the First Step of the Proposed Transaction." *Id.* at 12 (emphasis added).

- **Judge Greene:**

  "In order to avoid unnecessary delay and undue interference with business decisions, **the approval of the Court shall not be required [when a BOC acquires an option]. However, . . . the actual acquisition by a [BOC] of an equity interest in an entity engaged in activities prohibited by the decree may not occur without a waiver granted by the Court . . . .**" Memorandum at 6, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. Aug. 7, 1986) (emphasis added).

- **AT&T:**

"For example, what if an RHC secretly paid a billion dollars for a long-term transferrable option to purchase 100% of a major manufacturer at a nominal price. * * * The RHC could then sell the option and profit from the manufacturing business, without ever seeking a waiver. * * * [T]he very conduct the Decree sought to end would occur for years, ***without an RHC ever owning an actual equity interest*** in the manufacturer . . . ." Brief of AT&T, *United States v. Western Elec. Co.*, No. 86-5641, at 14-15 (D.C. Cir. filed June 26, 1989) (emphasis added).

"LACTC has two partners: (1) LIN Cellular Communications Corporation, a California corporation ('LIN Cellular'), in which ***McCaw holds a 52% equity interest and an option to acquire the remaining equity***, effective in January 1995 . . . ." Affidavit of Professor John C. Coffee, Jr., at 9, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed May 24, 1994) (emphasis added).

LIN was "52%-owned" by McCaw. AT&T's motion for a Waiver of Section I(D), at 8, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. filed June 7, 1994).

"QUESTION [from the D.C. Circuit Bench]: Some of those options were not [prohibited] under the original decree?

MR. CARPENTER: Some of those options would violate section 2 [of the MFJ] and some wouldn't."

Oral Argument Tr. at 25, *United States v. Western Elec. Co.*, Nos. 86-5641 & 86-5642 (D.C. Cir., Oct. 24, 1989).